An Introduction to Facilities and Administrative Costs

Sponsored projects include grants, contracts, and cooperative agreements accepted by the University of Kentucky Research Foundation (UKRF) on behalf of the university to conduct research (the most common type), instruction, and other projects (e.g., public service). The full cost of every sponsored project includes **direct costs** and **indirect costs**, which are formally known as **facilities and administrative costs** or F&A.

Direct costs are those funds used to carry out the project (e.g., salaries and benefits, equipment, supplies, travel). They can be allocated to a particular project with a high degree of accuracy. In contrast, F&A costs represent the portion of university expenses that provide the shared services, facilities, and administrative infrastructure needed to support all projects. Because such shared costs cannot be identified readily and specifically with a particular project, it is more reasonable and cost effective to charge sponsors through a pooled mechanism.

Federal regulations governing project costs are described in Office of Management & Budget (OMB) Circular A-21 (**Cost Principles for Educational Institutions**) promulgated at 2 CFR Part 220. An overview of F&A rate setting can be found in Appendix A. Briefly, the university conducts a detailed analysis to determine its actual costs. Those costs are allocated to two buckets that represent either “facilities” (e.g., utilities, operations and maintenance, depreciation, interest on debt, etc.) or “administrative” (e.g., general and research administration, purchasing, accounting, legal services, etc.) costs. An F&A rate proposal (300+ pages) is submitted to the federal government, and there is a negotiation. The process is repeated about every four years. The most recent analysis and rate proposal were done in 2011. We are currently awaiting the government’s response to our proposal.

**Some facts about F&A costs:**

1. F&A income is a reimbursement for expenses *already incurred* by the university in support of sponsored projects. UKRF does not get a check for F&A costs when a project is funded. UKRF does not get paid until *after* the direct costs are actually expended. If investigators conserve grant funds, no F&A income is received.

2. The F&A rate negotiated with the federal government is *always* less than the actual rate. No university recovers its full indirect costs. The difference is usually several percentage points.

3. University regulations require that sponsors be charged the full cost of an extramurally funded project. Consequently, it is policy that all grants, contracts, and other sponsored agreements accepted by UKRF are charged the maximum allowable federally negotiated F&A rate. However…
4. Not all federally funded projects can be charged the fully negotiated F&A rate. Although the university supposedly negotiates an F&A rate with the entire federal government, not all federal grants and contracts provide that rate of reimbursement. For example, training grants from the National Institutes of Health (NIH) are limited to 8% F&A. The Health Resources Services Administration (HRSA) caps some of its awards at 15%. The Department of Agriculture has statutory authority from Congress to limit F&A rates to between 10% and 30% depending on the program.

5. An exception from the policy of charging full F&A costs is granted to non-profit sponsors (e.g., foundations) and federal, state and local governmental agencies that have explicit, published policies limiting the F&A rate they will pay. This is particularly an issue for sponsored agreements from the Commonwealth of Kentucky, where most cabinets provide no F&A and none exceeds 30%. In fact, the average effective F&A rate from the state is only 1.4%!

6. Figure 1 shows a comparison of the actual F&A rate, the federally negotiated F&A rate and the effective F&A rate for on-campus research projects. Overall, the university recovers only about half of its actual F&A expenses for research done on campus. The effective F&A rate reflects the F&A income realized relative to actual project expenditures, excluding equipment, capital expenditures, patient care costs, tuition remission, rental costs for off-campus facilities, as well as the portion of each sub-award in excess of $25,000 (also known as Modified Total Direct Costs or MTDC).

![On-campus Research F&A Rate](image)
7. As shown in Figure 2, the effective F&A rate is even lower for on-campus projects in instruction and public service.

![Bar chart showing negotiated and effective F&A rates for instruction and public service]

Figure 2

8. When the sponsor of a project does not pay the negotiated F&A rate, the unrecovered F&A costs do not go away. The university has no choice but to absorb the shortfall. One way or another, this results in diversion of university funds that could be used to support other missions. Figure 3 shows that in FY2011, the university incurred about $95 million in F&A costs. Of that amount, 45% had to be covered from institutional funds.
Appendix A: How is the F&A rate determined?

In 1991, OMB imposed a 26% cap on the administrative cost component of F&A rates. Higher education is the only “industry” that has its administrative costs capped. Since then, administrative costs have risen substantially due to increasing government regulations. Nearly every university’s administrative costs exceed the cap. Because of the OMB limitation, the facilities cost pool plays the more critical role in determining the university’s overall F&A costs rate. The key to this component is an extensive and detailed “space survey” that involves a physical inventory of all space and an estimate of the fraction of that space used for federally sponsored projects. Facilities costs include such things as depreciation on buildings and equipment (except for those purchased with federal funds), interest on debt associated with capital assets, utilities, and maintenance costs. The accuracy of calculating these costs depends on the accuracy of the space survey and documenting the actual costs of building operations.

Once all of the F&A costs have been assigned to one of the buckets, they must be distributed across the major functions of the university, which are set forth in OMB Circular A-21 as instruction, organized research, other sponsored activities, and other institutional activities. A-21 also provides for consistent treatment of likes costs according to Cost Accounting Standards stipulated in the circular. Different rates are used for on-campus and off-campus activities, where off-campus involves only administrative costs. The University of Kentucky has a separate rate for agricultural research.

Once the F&A cost information has been assembled and appropriately documented, it is submitted to the university’s cognizant federal agency, the Division of Cost Allocation (DCA) of the Department of Health & Human Services. Typically, there are some differences in the interpretation of the rate development process that leads to a negotiation and a compromise between the university and the agency. Once the negotiation is concluded, the F&A rate agreement is formally signed by DCA and the university. Typically, the process is repeated about every four years. The last rate analysis was done and the rate proposal was submitted in 2011. A summary of the actual rates is shown in the table below.
The current federally negotiated F&A rates are shown below:

<table>
<thead>
<tr>
<th>F&amp;A Rate</th>
<th>On Campus</th>
<th>Off Campus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research</td>
<td>48.5%</td>
<td>26.0%</td>
</tr>
<tr>
<td>Instruction</td>
<td>45.0%</td>
<td>26.0%</td>
</tr>
<tr>
<td>Other sponsored activities</td>
<td>33.9%</td>
<td>21.6%</td>
</tr>
<tr>
<td>Agricultural research</td>
<td>39.0%</td>
<td>19.2%</td>
</tr>
</tbody>
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*Regardless of the actual rate, these are capped at 26%*